

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name	County
Fiscal Year End	Opinion Date	Date Audit Report Submitted to State	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).


YES
NO

Check each applicable box below. (See instructions for further detail.)

1. ☐ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☐ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☐ ☐ The local unit has adopted a budget for all required funds.
5. ☐ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☐ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☐ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☐ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☐ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☐ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☐ The local unit is free of repeated comments from previous years.
12. ☐ ☐ The audit opinion is UNQUALIFIED.
13. ☐ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☐ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☐ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input type="checkbox"/>			
The letter of Comments and Recommendations	<input type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>			
Certified Public Accountant (Firm Name)		Telephone Number		
Street Address		City	State	Zip
Authorizing CPA Signature		Printed Name		License Number

City of Mt. Morris, Michigan

**Financial Report
with Supplemental Information
June 30, 2006**

City of Mt. Morris, Michigan

Contents

Report Letter	1-2
Management's Discussion and Analysis	3-9
Basic Financial Statements	
Government-wide Financial Statements:	
Statement of Net Assets	10
Statement of Activities	11-12
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	13
Statement of Revenue, Expenditures, and Changes in Fund Balances	14
Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	15
Proprietary Funds:	
Statement of Net Assets	16
Statement of Revenue, Expenses, and Changes in Net Assets	17
Statement of Cash Flows	18
Fiduciary Fund - Statement of Assets and Liabilities	19
Notes to Financial Statements	20-37
Required Supplemental Information	38
Budgetary Comparison Schedule - General Fund	39-40
Budgetary Comparison Schedule - Major Special Revenue Fund	41
Notes to Required Supplemental Information	42-43

City of Mt. Morris, Michigan

Contents (Continued)

Other Supplemental Information	44
Nonmajor Governmental Funds:	
Combining Balance Sheet	45
Combining Statement of Revenue, Expenditures, and Changes in Fund Balances	46
Internal Service Funds:	
Combining Statement of Net Assets	47
Combining Statement of Revenue, Expenses, and Changes in Net Assets	48
Combining Statement of Cash Flows	49

Independent Auditor's Report

To the City Council
City of Mt. Morris, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Mt. Morris, Michigan (the "City") as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Mt. Morris, Michigan's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Mt. Morris, Michigan as of June 30, 2006 and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and the budgetary comparison schedules, as identified in the table of contents, are not a required part of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

To the City Council
City of Mt. Morris, Michigan

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Mt. Morris, Michigan's basic financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The other supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Plante & Moran, PLLC

August 30, 2006

City of Mt. Morris, Michigan

Management's Discussion and Analysis

Using this Annual Report

The annual report consists of a series of narratives and financial statements. This narrative is intended to serve as an introduction to the City of Mt. Morris' (the "City") basic financial statements. The basic financial statements consist of three components: government-wide financial statements, fund financial statements, and the notes to the financial statements. This report also contains other supplemental information.

The format of the annual report was modified in 2004 to comply with the reporting requirements of Government Accounting Standards Board Statement No. 34. The basic financial statements include two kinds of statements that present different views of the City. The statement of net assets and the statement of activities provide information about the activities of the City on a government-wide basis. They are designed to present a long-term view of the City's finances. The fund financial statements, which follow the above-mentioned statements, illustrate how the services provided by the City were financed in the short term, as well as what remains for future spending. Additionally, the fund financial statements report the City's operations in more detail than the government-wide financial statements.

Government-wide Statements

The government-wide statements provide information about the City as a whole, using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the City's assets and liabilities. Net assets, the difference between the City's assets and liabilities, are one way to measure the City's overall financial health. The statement of activities reflects all of the current year's revenues and expenses, regardless of when cash is actually received or paid.

The government-wide financial statements of the City are divided into three categories:

- **Governmental activities** - Most of the City's basic services are included here such as police, fire, public works, recreation, and general administration. Property taxes, state-shared revenues, charges for services, and grants provide the majority of the funding.
- **Business-type activities** - The City charges user fees to customers to cover costs of providing water and sewer services.
- **Component unit** - Downtown Development Authority (DDA) activities - The DDA has a separate property tax millage and captures a portion of other community assessed property taxes to properly develop and upkeep designated areas within the City.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

Fund Financial Statements

The fund financial statements provide more detailed information about the City's most significant funds, not the City as a whole. Funds are accounting tools that the City uses to keep track of specific sources of funding or monitor spending. Some funds are required to be separately maintained by State law. The City Council establishes other funds to control and manage money for particular purposes.

The City has three kinds of funds:

- Governmental funds - Most of the City's basic services are included in governmental funds, which focus on how cash, and other financial assets that can be converted to cash, flow in and out, and the balance left at year end that is available for future spending. The governmental fund statements provide a detailed short-term view that highlights whether there are more or fewer financial resources available in the near future to finance the City's programs. Because the focus of governmental funds is narrower, it is useful to compare this information with similar information presented for governmental activities in the government-wide financial statements. Both the balance sheet and the statement of revenues, expenditures, and changes in fund balance for the governmental funds provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains eight individual governmental funds. Information is presented separately in the governmental fund balance sheet and statement of revenues, expenditures, and changes in fund balances for the General Fund, Housing Development Grant Fund, Major Streets Fund, and Special Assessment Debt Service Fund, all of which are considered to be major funds. Data for the other four governmental funds is combined into a single, aggregated presentation. Individual fund data for the nonmajor governmental funds is provided in the form of combining statements located in the other supplemental information section of this report.

The City adopts an annual appropriated budget for all of its governmental funds. Budgetary comparison statements have been provided for all major governmental funds to demonstrate budgetary compliance.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

- Proprietary funds - Proprietary fund reporting, like government-wide statements, provide both short-term and long-term financial information. The City maintains two different types of proprietary funds. Enterprise Funds are used to report the same functions presented in the business-type activities in the government-wide financial statements. The City uses an Enterprise Fund to account for its water and sewer operation. This fund is considered a major fund of the City. Internal Service Funds accumulate and allocate costs internally among various functions. The City uses Internal Service Funds to account for its vehicles and machinery equipment used by all funds within the City and to account for retiree benefit expenditures. Because these programs predominantly benefit governmental rather than business-type functions, they have been consolidated within the governmental activities in the government-wide financial statements.
- Fiduciary funds - Fiduciary funds are used to account for resources held for the benefit of parties outside of the City. Fiduciary funds are not reflected in the government-wide financial statements because the resources held in those funds are not available to finance the City's programs.

Notes to the Financial Statements

Notes to the financial statements provide additional information that is essential to the full understanding of the data provided in the government-wide and fund financial statements.

Required Supplemental Information

The required supplemental information is in addition to the basic financial statements and accompanying notes. This section of the report highlights the City's progress in funding its obligations to provide pension and other postemployment benefits to its employees. In addition, this section includes the budgetary comparison statements for the General Fund and major Special Revenue Funds.

Other Supplemental Information

The combining fund statements referred to earlier, as well as the City's combining Internal Service Funds, are presented immediately following the required supplemental information section of this report.

The City of Mt. Morris, Michigan as a Whole

The City's combined total net assets are approximately \$3.2 million. Looking at the governmental activities, separate from the business-type activities, you can see that the governmental activities experienced a decrease of approximately \$800,000 in net assets. This was the result of the recording of bad debt expense related to a special assessment receivable deemed to be uncollectible. Business-type activities remained unchanged from a year ago.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

In a condensed format, the table below shows the comparison of net assets (in millions of dollars) as of June 30, 2006 to the prior year:

TABLE I

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Assets						
Current assets	\$ 0.8	\$ 0.9	\$ 0.5	\$ 0.6	\$ 1.3	\$ 1.5
Noncurrent assets	<u>2.7</u>	<u>3.3</u>	<u>3.2</u>	<u>3.3</u>	<u>5.9</u>	<u>6.6</u>
Total assets	3.5	4.2	3.7	3.9	7.2	8.1
Liabilities						
Current liabilities	0.4	0.3	0.1	0.2	0.5	0.5
Long-term liabilities	<u>2.4</u>	<u>2.4</u>	<u>1.1</u>	<u>1.2</u>	<u>3.5</u>	<u>3.6</u>
Total liabilities	<u>2.8</u>	<u>2.7</u>	<u>1.2</u>	<u>1.4</u>	<u>4.0</u>	<u>4.1</u>
Net Assets						
Invested in capital assets -						
Net of related debt	0.7	0.7	2.1	2.1	2.8	2.8
Restricted	0.5	0.7	0.1	0.1	0.6	0.8
Unrestricted	<u>(0.5)</u>	<u>0.1</u>	<u>0.3</u>	<u>0.3</u>	<u>(0.2)</u>	<u>0.4</u>
Total net assets	<u>\$ 0.7</u>	<u>\$ 1.5</u>	<u>\$ 2.5</u>	<u>\$ 2.5</u>	<u>\$ 3.2</u>	<u>\$ 4.0</u>

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

The following table shows the changes of the net assets (in millions of dollars) for the year ended June 30, 2006:

Summary Condensed Income Statement (normally presented in thousands of dollars):

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Revenue						
Program revenue:						
Charges for services	\$ 0.4	\$ 0.4	\$ 1.2	\$ 1.1	\$ 1.6	\$ 1.5
Operating grants and contributions	0.2	0.2	-	-	0.2	0.2
Capital grants and contributions	-	0.8	-	0.5	-	1.3
General revenue:						
Property taxes	0.7	0.7	-	-	0.7	0.7
State-shared revenue	0.4	0.4	-	-	0.4	0.4
Miscellaneous	0.2	0.1	-	-	0.2	0.1
Total revenue	1.9	2.6	1.2	1.6	3.1	4.2
Program Expenses						
General government	0.5	0.5	-	-	0.5	0.5
Public safety	0.9	0.8	-	-	0.9	0.8
Public works	1.2	1.0	-	-	1.2	1.0
Interest on long-term debt	0.1	0.1	-	-	0.1	0.1
Water and sewer	-	-	1.2	1.1	1.2	1.1
Total program expenses	2.7	2.4	1.2	1.1	3.9	3.5
Change in Net Assets	\$ (0.8)	\$ 0.2	\$ -	\$ 0.5	\$ (0.8)	\$ 0.7

Governmental Activities

Looking at the table above you will see that the major difference in both governmental activities and business-type activities revenue is in capital grants and contributions. The decrease in revenue is due primarily to the Woodside Trails special assessment bond. The special assessment bond for Woodside Trails was a one-time revenue in fiscal year 2005.

Expenditures for the City's governmental activities increased by \$300,000 from the previous year and expenditures were over current revenues by \$800,000 due to the public safety fringe benefits being higher than anticipated, the adjusting of old and unknown account balances, and the write off of the Woodside Trails special assessment receivable.

The City continued meeting the actuarial required contributions for its defined benefit pension system. This required contribution was \$147,338, an increase of \$44,525 from the previous year.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

Business-type Activities

The City has one business-type activity, the Water and Sewer Fund. Water and sewer operations are funded directly by user fees or charges for services. Revenues of the City's Water and Sewer Fund fell short of expenses by approximately \$57,000, meaning the Enterprise Fund ended the year with a net operating loss.

In fiscal year 2003, the City revised the water and sewer rate structure. The revised water and sewer rate structure serves to better isolate the effects of cost increases to the City and to become more compliant with State regulations. The City will be reviewing the water and sewer rates periodically to ensure the rates are covering the costs of the system.

The City's Funds

The analysis of the City's major funds follows the government-wide financial statements. The fund financial statements provide detailed information about the most significant funds, not the City as a whole. The City Council creates funds to help manage money for specific purposes as well as to show accountability for certain activities, such as State of Michigan Act 51 major and local road revenue sharing. The City's major funds for 2006 include the General Fund, Housing Development Grant Fund, Major Streets Fund, and the Special Assessment Debt Service Fund.

The General Fund pays for most of the City's governmental services. The most significant of these are police and fire, which incurred expenditures of approximately \$870,000. The general operating millage levied by the City helps supports these two services. The Major Streets Fund is used by the City to account for capital outlay expenditures related to road construction and maintenance. State revenue sources and transfers from other funds support the activity in this fund. Lastly, the Housing Development Grant Fund is a grant given to the City from HUD and loaned out to a developer.

General Fund Budgetary Highlights

As of the close of the current fiscal year, the City's General Fund has an unreserved fund deficit of \$8,234. This is a \$147,058 decrease in comparison with the prior year, or 8.4 percent of total General Fund expenditures.

During the fiscal year, the budget was amended in a legally permissible manner.

City of Mt. Morris, Michigan

Management's Discussion and Analysis (Continued)

Capital Assets and Long-term Debt Administration

At the end of fiscal year 2006, the City had approximately \$4.6 million invested in a wide range of capital assets, including land, buildings, police and fire equipment, computer equipment, and water and sewer lines.

In addition, the City had approximately \$2.7 million in debt obligations related to general obligation bonds, installment purchase obligations, and revenue bonds. During fiscal year 2006, the City purchased a new fire truck costing \$236,416. The fire truck was financed with an installment purchase agreement of \$158,000, Community Development Block Grant monies of \$10,000, a Water Fund loan of \$25,000, and a loan from the DDA in the amount of \$43,416.

Economic Factors and Next Year's Budgets and Rates

As of the end of the current fiscal year, the City's General Fund unreserved fund balance has been completely eliminated. The unreserved fund balance deficit in the General Fund totals \$8,234, a decrease of \$147,058. While revenues in the General Fund increased approximately 1 percent from the prior year, expenditures also increased by approximately 7.5 percent from the prior year. The City is facing very challenging financial times and will be developing a three-to five-year operational and capital plan.

In fiscal year 2003, the City restructured the water and sewer rates for the Water and Sewer Fund to conform to local and state regulations. The City will need to continue to revise its rates in order to address future costs and needs of the system.

Contacting the City's Management

This financial report is intended to provide our citizens, taxpayers, customers, and investors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional information, we welcome you to contact the City's office.

City of Mt. Morris, Michigan

Statement of Net Assets June 30, 2006

	Primary Government			Component Unit - DDA
	Governmental Activities	Business-type Activities	Total	
Assets				
Cash and investments (Note 3)	\$ 615,373	\$ 203,476	\$ 818,849	\$ 82,796
Receivables:				
Customer	15,200	148,711	163,911	-
Special assessment - Net of allowance for doubtful accounts of \$724,474	-	-	-	-
Housing Development receivable (Note 4)	1,000,000	-	1,000,000	-
Due from other governmental units	162,274	-	162,274	-
Due from component unit	3,484	-	3,484	-
Advance to primary government	-	-	-	38,916
Advance to other funds (Note 6)	-	25,000	25,000	-
Internal balances	20,058	(20,058)	-	-
Other	12,111	-	12,111	-
Inventories, prepaids, and other assets	-	31,997	31,997	-
Land held for resale	355,663	-	355,663	-
Restricted assets (Note 8)	-	87,653	87,653	-
Capital assets - Net (Note 5):				
Nondepreciable capital assets	642,126	18,744	660,870	40,000
Depreciable capital assets - Net	730,496	3,211,799	3,942,295	64,600
Total assets	3,556,785	3,707,322	7,264,107	226,312
Liabilities				
Accounts payable	76,365	41,556	117,921	-
Accrued and other liabilities	81,967	18,168	100,135	-
Due to primary government	-	-	-	3,484
Advance from component unit	38,916	-	38,916	-
Advance from other funds (Note 6)	25,000	-	25,000	-
Deferred revenue (Note 4)	1,000,000	-	1,000,000	-
Noncurrent liabilities (Note 7):				
Due within one year	163,841	84,600	248,441	8,000
Due in more than one year	1,425,980	1,060,044	2,486,024	-
Total liabilities	2,812,069	1,204,368	4,016,437	11,484
Net Assets				
Invested in capital assets - Net of related debt	742,089	2,085,899	2,827,988	96,600
Restricted:				
Streets and highways	348,737	-	348,737	-
Cemetery care	63,457	-	63,457	-
Other	9,556	-	9,556	-
Special assessment debt service	93,304	-	93,304	-
Water and sewer debt service	-	87,653	87,653	-
Unrestricted	(512,427)	329,402	(183,025)	118,228
Total net assets	\$ 744,716	\$ 2,502,954	\$ 3,247,670	\$ 214,828

City of Mt. Morris, Michigan

	Program Revenues		
	Charges for	Operating	Capital Grants
Expenses	Services	Grants and	and
		Contributions	Contributions
Functions/Programs			
Primary government:			
Governmental activities:			
General government	\$ 498,479	\$ 87,961	\$ 23,889
Public safety	876,521	112,440	6,060
Public works	1,159,791	125,822	200,416
Recreation and culture	28,272	-	-
Interest on long-term debt	67,092	-	-
Total governmental activities	2,630,155	326,223	230,365
Business-type activities - Water and sewer	1,228,214	1,146,762	-
Total primary government	<u>\$ 3,858,369</u>	<u>\$ 1,472,985</u>	<u>\$ 230,365</u>
Component unit - Downtown Development Authority	<u>\$ 11,920</u>	<u>\$ -</u>	<u>\$ -</u>
General revenues:			
Property taxes			
State-shared revenues			
Unrestricted investment earnings			
Miscellaneous			
Total general revenues			
Change in Net Assets			
Net Assets - Beginning of year			
Net Assets - End of year			

Statement of Activities
Year Ended June 30, 2006

Net (Expense) Revenue and Changes in Net Assets			
Primary Government			Component Unit - DDA
Governmental Activities	Business-type Activities	Total	
\$ (386,629)	\$ -	\$ (386,629)	\$ -
(758,021)	-	(758,021)	-
(823,553)	-	(823,553)	-
(28,272)	-	(28,272)	-
(67,092)	-	(67,092)	-
(2,063,567)	-	(2,063,567)	-
-	(64,562)	(64,562)	-
(2,063,567)	(64,562)	(2,128,129)	-
-	-	-	(11,920)
744,891	-	744,891	74,345
404,271	-	404,271	-
67,793	7,319	75,112	2,919
78,520	-	78,520	-
1,295,475	7,319	1,302,794	77,264
(768,092)	(57,243)	(825,335)	65,344
1,512,808	2,560,197	4,073,005	149,484
\$ 744,716	\$ 2,502,954	\$ 3,247,670	\$ 214,828

City of Mt. Morris, Michigan

Governmental Funds Balance Sheet June 30, 2006

	Major Special Revenue Funds					
		Housing	Major Streets	Special	Other	Total
	General Fund	Development	Fund	Assessment	Nonmajor	Total
		Grant Fund		Debt Service	Governmental	Governmental
			Fund	Fund	Funds	Funds
Assets						
Cash and cash equivalents (Note 3)	\$ 26,568	\$ -	\$ 275,159	\$ 93,304	\$ 136,048	\$ 531,079
Receivables:						
Customers	15,200	-	-	-	-	15,200
Special assessment - Net of allowance for doubtful accounts of \$724,474	-	-	-	-	-	-
Due from other governmental units	49,715	-	24,764	-	8,328	82,807
Due from component unit	3,484	-	-	-	-	3,484
Other	12,109	-	-	-	-	12,109
Due from other funds (Note 6)	25,720	-	-	-	-	25,720
Housing Development receivable (Note 4)	-	1,000,000	-	-	-	1,000,000
Land held for resale	355,663	-	-	-	-	355,663
Total assets	<u>\$ 488,459</u>	<u>\$ 1,000,000</u>	<u>\$ 299,923</u>	<u>\$ 93,304</u>	<u>\$ 144,376</u>	<u>\$ 2,026,062</u>
Liabilities and Fund Balances						
Liabilities						
Accounts payable	\$ 70,061	\$ -	\$ 1,510	\$ -	\$ -	\$ 71,571
Accrued and other liabilities	61,413	-	736	-	1,420	63,569
Due to other funds (Note 6)	-	-	2,831	-	2,831	5,662
Deferred revenue (Note 4)	-	1,000,000	-	-	-	1,000,000
Total liabilities	131,474	1,000,000	5,077	-	4,251	1,140,802
Fund Balances						
Reserved in:						
General Fund (Note 9)	365,219	-	-	-	-	365,219
Cemetery Care Fund	-	-	-	-	63,457	63,457
Unreserved - Reported in:						
General Fund	(8,234)	-	-	-	-	(8,234)
Special Revenue Funds	-	-	294,846	93,304	53,891	442,041
Debt Service Funds	-	-	-	-	1,457	1,457
Capital Projects Fund	-	-	-	-	21,320	21,320
Total fund balances	<u>356,985</u>	<u>-</u>	<u>294,846</u>	<u>93,304</u>	<u>140,125</u>	<u>885,260</u>
Total liabilities and fund balances	<u>\$ 488,459</u>	<u>\$ 1,000,000</u>	<u>\$ 299,923</u>	<u>\$ 93,304</u>	<u>\$ 144,376</u>	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and are not reported in the funds	919,919
State-shared revenue receivable are to be collected next fiscal year, relating to the State's sales tax year	79,467
Accrued interest payable is not due and payable in the current period and is not reported in the funds	(14,256)
Long-term liabilities are not due and payable in the current period and are not reported in the funds	(1,307,784)
Internal Service Funds are included as part of governmental activities	182,110
Net assets of governmental activities	\$ 744,716

City of Mt. Morris, Michigan

Governmental Funds Statement of Revenue, Expenditures, and Changes in Fund Balances Year Ended June 30, 2006

	Major Special Revenue Funds					
	General Fund	Housing Development Grant Fund	Major Streets Fund	Special Assessment Debt Service Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
Revenue						
Property taxes	\$ 744,891	\$ -	\$ -	\$ -	\$ -	\$ 744,891
Special assessment	-	-	-	126,893	-	126,893
Licenses and permits	20,258	-	-	-	-	20,258
Federal sources	23,889	-	-	-	-	23,889
State sources	407,093	-	149,975	-	50,441	607,509
Charges for services	225,207	-	-	-	-	225,207
Fines and forfeitures	56,822	-	-	-	-	56,822
Interest	6,705	-	9,791	44,905	4,192	65,593
Rents, royalties, and other	145,540	-	12,797	-	8,887	167,224
Total revenue	1,630,405	-	172,563	171,798	63,520	2,038,286
Expenditures						
General government	514,805	-	-	-	-	514,805
Public safety	864,325	-	-	-	-	864,325
Public works	269,898	-	128,843	-	75,630	474,371
Recreation, cultural, and other	94,475	-	-	-	102	94,577
Debt service	-	-	-	78,494	45,670	124,164
Total expenditures	1,743,503	-	128,843	78,494	121,402	2,072,242
Excess of Revenue Over (Under)						
Expenditures	(113,098)	-	43,720	93,304	(57,882)	(33,956)
Other Financing Sources (Uses)						
Transfers in (Note 6)	200	-	-	-	56,450	56,650
Transfers out (Note 6)	(45,450)	-	(11,000)	-	(200)	(56,650)
Total other financing sources (uses)	(45,250)	-	(11,000)	-	56,250	-
Change in Fund Balance	(158,348)	-	32,720	93,304	(1,632)	(33,956)
Fund Balances - July 1, 2005	515,333	-	262,126	-	141,757	919,216
Fund Balances - June 30, 2006	<u>\$ 356,985</u>	<u>\$ -</u>	<u>\$ 294,846</u>	<u>\$ 93,304</u>	<u>\$ 140,125</u>	<u>\$ 885,260</u>

City of Mt. Morris, Michigan

Governmental Funds Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities Year Ended June 30, 2006

Net Change in Fund Balances - Total Governmental Funds **\$ (33,956)**

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures; in the statement of activities, these costs are allocated over their estimated useful lives as depreciation	7,884
Revenue reported in the statement of activities that does not provide current financial resources and is not reported as revenue in the governmental funds (GASB No. 33)	1,018
Revenues reported in the statement of activities in previous years did not provide current financial resources in the governmental funds until the current year	(125,526)
Proceeds from the sale of capital assets reported as revenues in the governmental funds; the statement of activities recorded a gain or loss, included in miscellaneous revenue	(3,925)
Repayment of bond principal is an expenditure in the governmental funds, but not in the statement of activities (where it reduces long-term debt)	65,000
Write off of uncollectible special assessment receivable shown as public works expense in the statement of activities; in the governmental funds it is a reduction of deferred revenue	(724,474)
Interest expense is recorded when incurred in the statement of activities	819
Net decrease in accumulated employee sick and vacation pay and estimated general liability claims is recorded when earned in the statement of activities	29,087
Internal Service Funds are also included as governmental activities	<u>15,981</u>

Change in Net Assets of Governmental Activities **\$ (768,092)**

City of Mt. Morris, Michigan

Proprietary Funds Statement of Net Assets June 30, 2006

	Enterprise - Water and Sewer Fund	Internal Service Funds
Assets		
Current assets:		
Cash and cash equivalents (Note 3)	\$ 203,476	\$ 84,294
Customer receivables	148,711	-
Inventory	31,997	-
Total current assets	384,184	84,294
Noncurrent assets:		
Advance to other funds (Note 6)	25,000	-
Restricted assets (Note 8)	87,653	-
Nondepreciable capital assets (Note 5)	18,744	-
Depreciable capital assets - Net (Note 5)	3,211,799	452,703
Total noncurrent assets	3,343,196	452,703
Total assets	3,727,380	536,997
Liabilities		
Current liabilities:		
Accounts payable	41,556	4,794
Due to other funds (Note 6)	20,058	-
Accrued and other liabilities	18,168	4,140
Current portion of long-term debt (Note 7)	84,600	46,057
Total current liabilities	164,382	54,991
Noncurrent liabilities:		
Advance from other funds (Note 6)	-	25,000
Advance from component unit (Note 6)	-	38,916
Noncurrent liabilities - Long-term debt - Net of current portion (Note 7)	1,060,044	235,980
Total noncurrent liabilities	1,060,044	299,896
Total liabilities	1,224,426	354,887
Net Assets		
Invested in capital assets - Net of related debt	2,085,899	106,750
Restricted for debt service	87,653	-
Unrestricted	329,402	75,360
Total net assets	<u>\$ 2,502,954</u>	<u>\$ 182,110</u>

City of Mt. Morris, Michigan

Proprietary Funds Statement of Revenue, Expenses, and Changes in Net Assets Year Ended June 30, 2006

	Enterprise - Water and Sewer Fund	Internal Service Funds
Operating Revenue		
Charges for services	\$ 1,090,016	\$ 316,403
Fines and forfeitures	55,467	-
Other income	1,279	10
Total operating revenue	1,146,762	316,413
Operating Expenses		
Cost of water/sewer	477,509	-
Wages and salaries	180,525	20,615
Fringe benefits	101,453	10,540
Supplies	201	31,395
Operating	43,825	69,148
Professional services	44,520	-
Insurance	9,426	25,696
Rental	204,369	-
Retiree benefit payments	-	94,092
Depreciation	109,650	52,501
Total operating expenses	1,171,478	303,987
Operating Income (Loss)	(24,716)	12,426
Nonoperating Revenue (Expense)		
Federal sources	-	10,000
Interest income	7,319	2,302
Interest expense	(56,736)	(8,747)
Total nonoperating revenue (expense)	(49,417)	3,555
Income (Loss) - Before capital contributions	(74,133)	15,981
Capital Contributions - Local contributions	16,890	-
Change in Net Assets	(57,243)	15,981
Net Assets - Beginning of year	2,560,197	166,129
Net Assets - End of year	<u>\$ 2,502,954</u>	<u>\$ 182,110</u>

City of Mt. Morris, Michigan

Proprietary Funds Statement of Cash Flows Year Ended June 30, 2006

	Enterprise - Water and Sewer Fund	Internal Service Funds
Cash Flows from Operating Activities		
Receipts from customers	\$ 1,156,295	\$ 316,413
Payments to suppliers	(788,470)	(218,608)
Payments to employees	(281,523)	(31,155)
Other receipts	19,814	2,384
Net cash provided by operating activities	106,116	69,034
Cash Flows from Capital and Related Financing Activities		
Purchase of capital assets	-	(283,747)
Tap-in fees	16,890	-
Proceeds from issuance of debt	-	158,000
Funds received from federal sources	-	10,000
Advances from (to) other funds/governmental units	(25,000)	63,916
Principal and interest paid on capital debt	(136,336)	(37,059)
Net cash used in capital and related financing activities	(144,446)	(88,890)
Cash Flows from Investing Activities - Interest received on investments	7,317	2,302
Net Decrease in Cash and Cash Equivalents	(31,013)	(17,554)
Cash and Cash Equivalents - Beginning of year	322,142	101,848
Cash and Cash Equivalents - End of year	<u>\$ 291,129</u>	<u>\$ 84,294</u>
Balance Sheet Classification of Cash and Cash Equivalents		
Cash and investments	\$ 203,476	\$ 84,294
Restricted cash and investments	87,653	-
Total cash and cash equivalents	<u>\$ 291,129</u>	<u>\$ 84,294</u>
Reconciliation of Operating Income (Loss) to Net Cash from Operating Activities		
Operating income (loss)	\$ (24,716)	\$ 12,426
Adjustments to reconcile operating income (loss) to net cash from operating activities:		
Depreciation and amortization	109,650	52,501
Changes in assets and liabilities:		
Receivables	34,532	-
Due from other funds	-	18
Accounts payable	(8,620)	1,723
Accrued and other liabilities	(4,730)	2,366
Net cash provided by operating activities	<u>\$ 106,116</u>	<u>\$ 69,034</u>

Noncash Investing, Capital, and Financing Activities - During the year ended June 30, 2006, there were no noncash activities.

City of Mt. Morris, Michigan

Fiduciary Fund Statement of Assets and Liabilities June 30, 2006

	Trust and Agency Fund
	<hr/>
Assets - Cash and cash equivalents	\$ 4,112
	<hr/>
Liabilities - Accrued and other liabilities	\$ 4,112
	<hr/>

Note 1 - Summary of Significant Accounting Policies

The accounting policies of the City of Mt. Morris, Michigan (the "City") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the City:

Reporting Entity

The City is governed by an elected seven-member council. The accompanying financial statements present the City and its component unit, an entity for which the City is considered to be financially accountable. Although blended component units are legal separate entities, in substance, they are part of the City's operations. The discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize that it is legally separate from the City (see discussion below for description).

Discretely Presented Component Unit - The Downtown Development Authority (DDA) was created to correct and prevent deterioration in the downtown district, encourage historical preservation, and to promote economic growth within the downtown district. The DDA's governing body, consisting of eight to 11 individuals, is selected by the mayor with City Council approval. In addition, the DDA's budget is subject to approval by the City.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

Note 1 - Summary of Significant Accounting Policies (Continued)

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund, fiduciary fund, and component unit financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. The following major revenue sources meet the availability criterion: state gas and weight tax revenue and interest associated with the current fiscal period. Conversely, federal grant reimbursements and state-shared revenues will be collected after the period of availability; receivables have been recorded for these, along with a "deferred revenue" liability when applicable.

Note 1 - Summary of Significant Accounting Policies (Continued)

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

The City reports the following major governmental funds:

General Fund - The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund. General Fund activities are financed by revenue from the general property taxes, state-shared revenue, and other sources.

Housing Development Grant Fund - The Housing Development Grant Fund is a grant given to the City from HUD to loan to a developer. The developer is to pay back the City by 2016 with no interest.

Major Streets Fund - The Major Streets Fund accounts for maintenance and improvement activities for streets designated as "major" within the City. Funding is provided through state-shared gas and weight taxes.

Special Assessment Debt Service Fund - The Special Assessment Debt Service Fund accounts for the payment of debt for the new special assessment district. Funding is provided by the receipt of special assessment collections for residents in the district.

The City reports the following major proprietary fund:

Water and Sewer Fund - The Water and Sewer Fund is used to account for the results of operations that provide water and sewer services to citizens that are financed primarily by a user charge for the provision of those services.

Additionally, the City reports the following fund types:

Internal Service Funds - Internal Service Funds are used to account for the financing of goods and services provided by one department or agency to other departments or agencies of the City, or to other governments, primarily on a cost-reimbursement basis.

Note 1 - Summary of Significant Accounting Policies (Continued)

Agency Funds - Agency Funds are used to account for assets held by the City in a trustee capacity. These funds are custodial in nature (assets equal liabilities) and do not involve the measurement of results of operations.

Private sector standards of accounting issued prior to December 1, 1989 are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The City has elected not to follow private sector standards issued after November 30, 1989 for its business-type activities.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City's water and sewer function and various other functions of the City. Eliminations of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenue include: (1) charges to customers or applicants for goods, services, or privileges provided, (2) operating grants and contributions, and (3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenue rather than as program revenue. Likewise, general revenue includes all taxes.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of our proprietary funds relates to charges to customers for sales and services. The Water and Sewer Fund also recognizes the portion of tap fees intended to recover current costs (e.g., labor and materials to hook up new customers) as operating revenue. The portion intended to recover the cost of the infrastructure is recognized as nonoperating revenue. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

Note 1 - Summary of Significant Accounting Policies (Continued)

Property Tax Revenue

Property taxes are levied on each July 1 on the taxable valuation of property as of the preceding December 31. The related taxes are billed on July 1 and become a lien on December 1 of the following year. Taxes are considered delinquent on September 16 of the same year, at which time penalties and interest are assessed.

The City's 2005 tax is levied and collectible on July 1, 2005 and is recognized as revenue in the year ended June 30, 2006, when the proceeds of the levy are budgeted and available for the financing of operations.

The 2005 taxable valuation of the City totaled \$41,443,542 (a portion of which is abated and a portion of which is captured by the DDA), on which taxes levied consisted of 18.1411 mills for operating purposes, resulting in \$713,505 for operating purposes. These amounts are recognized in the respective General Fund financial statements as tax revenue.

Assets, Liabilities, and Net Assets or Equity

Bank Deposits and Investments - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

Receivables and Payables - In general, outstanding balances between funds are reported as "due to/from other funds." Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "advances to/from other funds." Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as "internal balances."

All trade and property tax receivables are shown as net of allowance for uncollectible amounts.

Inventories and Prepaid Items - Inventories are valued at cost, on a first-in, first-out basis, which approximates market value.

Restricted Assets - The revenue bonds of the Enterprise Funds require amounts to be set aside for debt service principal and interest payments. These amounts have been classified as restricted assets.

Land Held for Resale - Land held for resale in the General Fund is valued at the lower of cost or market value.

Note 1 - Summary of Significant Accounting Policies (Continued)

Capital Assets - Capital assets, which include property, plant, equipment, and infrastructure assets on a prospective basis (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial individual cost of more than \$500 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Buildings, equipment, and vehicles are depreciated using the straight-line method over the following useful lives:

Water and sewer systems	20 to 50 years
Buildings and building improvements	50 years
Vehicles	5 to 8 years
Machinery, equipment, and other	5 to 10 years
Land improvements	50 years

Compensated Absences (Vacation and Sick Leave) - It is the City's policy to permit employees to accumulate earned but unused vacation pay benefits. All vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only for employee terminations as of year end.

Long-term Obligations - In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund-type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

Fund Equity - In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 1 - Summary of Significant Accounting Policies (Continued)

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Note 2 - Stewardship, Compliance, and Accountability

Construction Code Fees - The City oversees building construction, in accordance with the State's Construction Code Act, including inspection of building construction and renovation to ensure compliance with the building codes. The City charges fees for these services. The law requires that collection of these fees be used only for construction code costs, including an allocation of estimated overhead costs. A summary of the current year activity and the cumulative shortfall generated since January 1, 2000 is as follows:

Cumulative shortfall at July 1, 2005	\$ (9,936)
Current year building permit revenue	20,257
Direct costs of construction code expenses	<u>(30,701)</u>
Cumulative shortfall at June 30, 2006	<u>\$ (20,380)</u>

Fund Deficit - The deficit in the unreserved fund balance of the General Fund of \$8,234 will be eliminated in fiscal year 2006-2007 when the City disburses the net assets of the Internal Service Funds into the appropriate accounts in the General Fund.

Note 3 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan; and money market funds. The investment policy adopted by the Council is in accordance with statutory authority.

The City has designated two banks for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in all of the items described above.

The City's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City does not have a deposit policy for custodial credit risk. At year end, the City had \$167,795 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The City believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the City evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 3 - Deposits and Investments (Continued)

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The City has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Primary government - Bank investment pool	\$ 651,501	Not rated	N/A
Component unit - Bank investment pool	82,793	Not rated	N/A

Note 4 - Loan Receivable and Deferred Revenue - Housing Development Grant Fund

In 1985, the City of Mt. Morris received a grant to make loans for the development of Morris Square. The grant was received from Michigan State Housing Development Authority. It was loaned to Mt. Morris Square Limited Dividend Housing Association to be used as a development cost write-down. The \$1,000,000 loan is currently recorded as a loan receivable and deferred revenue. The loan agreement requires that the developer repay the loan in 2015, at the end of 30 years from the original loan date.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 5 - Capital Assets

Capital asset activity of the City's governmental and business-type activities was as follows:

	Balance July 1, 2005	Additions	Disposals and Adjustments	Balance June 30, 2006
Governmental Activities				
Other governmental capital assets:				
Capital assets not being depreciated:				
Land	\$ 372,226	\$ -	\$ (3,925)	\$ 368,301
Construction in progress	<u>273,825</u>	<u>-</u>	<u>-</u>	<u>273,825</u>
Subtotal	646,051	-	(3,925)	642,126
Capital assets being depreciated:				
Land improvements	178,485	-	-	178,485
Buildings	164,640	-	-	164,640
Machinery and equipment	<u>90,680</u>	<u>30,179</u>	<u>-</u>	<u>120,859</u>
Subtotal	433,805	30,179	-	463,984
Accumulated depreciation:				
Land improvements	9,293	3,220	-	12,513
Buildings	111,048	2,964	-	114,012
Machinery and equipment	<u>43,554</u>	<u>16,112</u>	<u>-</u>	<u>59,666</u>
Subtotal	<u>163,895</u>	<u>22,296</u>	<u>-</u>	<u>186,191</u>
Net capital assets being depreciated	<u>269,910</u>	<u>7,883</u>	<u>-</u>	<u>277,793</u>
Net other governmental capital assets	<u>\$ 915,961</u>	<u>\$ 7,883</u>	<u>\$ (3,925)</u>	<u>\$ 919,919</u>
Internal Service Funds assets:				
Capital assets being depreciated:				
Vehicles	\$ 863,215	\$ 283,747	\$ (30,000)	\$ 1,116,962
Machinery and equipment	<u>136,544</u>	<u>-</u>	<u>(800)</u>	<u>135,744</u>
Subtotal	999,759	283,747	(30,800)	1,252,706
Accumulated depreciation:				
Vehicles	656,969	46,901	(30,000)	673,870
Machinery and equipment	<u>121,333</u>	<u>5,600</u>	<u>(800)</u>	<u>126,133</u>
Subtotal	<u>778,302</u>	<u>52,501</u>	<u>(30,800)</u>	<u>800,003</u>
Net Internal Service Funds capital assets	<u>\$ 221,457</u>	<u>\$ 231,246</u>	<u>\$ -</u>	<u>\$ 452,703</u>
Governmental capital assets not being depreciated	\$ 646,051	\$ -	\$ (3,925)	\$ 642,126
Net governmental capital assets being depreciated	<u>491,367</u>	<u>239,129</u>	<u>-</u>	<u>730,496</u>
Net governmental activity capital assets	<u>\$ 1,137,418</u>	<u>\$ 239,129</u>	<u>\$ (3,925)</u>	<u>\$ 1,372,622</u>

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 5 - Capital Assets (Continued)

	Balance July 1, 2005	Additions	Disposals and Adjustments	Balance June 30, 2006
Business-type Activities				
Capital assets not being depreciated:				
Land	\$ 18,744	\$ -	\$ -	\$ 18,744
Construction in progress	-	-	-	-
Subtotal	18,744	-	-	18,744
Capital assets being depreciated:				
Buildings	10,300	-	-	10,300
Water and sewer system	4,949,402	-	-	4,949,402
Machinery, equipment, and other	109,845	-	-	109,845
Subtotal	5,069,547	-	-	5,069,547
Accumulated depreciation:				
Buildings	8,239	207	-	8,446
Water and sewer system	1,685,239	99,285	-	1,784,524
Machinery and equipment	54,620	10,158	-	64,778
Subtotal	1,748,098	109,650	-	1,857,748
Net capital assets being depreciated	3,321,449	(109,650)	-	3,211,799
Net capital assets	<u>\$ 3,340,193</u>	<u>\$ (109,650)</u>	<u>\$ -</u>	<u>\$ 3,230,543</u>

Capital asset activity for the City's component unit for the year was as follows:

	Balance July 1, 2005	Additions	Disposals and Adjustments	Balance June 30, 2006
Component Unit				
Capital assets not being depreciated -				
Land	\$ 40,000	\$ -	\$ -	\$ 40,000
Capital assets being depreciated -				
Land improvements	85,000	-	-	85,000
Accumulated depreciation - Land improvements	18,700	1,700	-	20,400
Net capital assets being depreciated	66,300	(1,700)	-	64,600
Net capital assets	<u>\$ 106,300</u>	<u>\$ (1,700)</u>	<u>\$ -</u>	<u>\$ 104,600</u>

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 5 - Capital Assets (Continued)

Depreciation expense was charged to programs of the primary government as follows:

Governmental activities:

General government	\$ 8,698
Public safety	11,060
Public works	53,108
Recreation and culture	<u>1,930</u>

Total governmental activities	<u>\$ 74,796</u>
-------------------------------	------------------

Business-type activities - Water and sewer	<u>\$ 109,650</u>
--	-------------------

Note 6 - Interfund Receivables, Payables, and Transfers

The composition of interfund balances is as follows:

Receivable Fund	Payable Fund	Amount
General Fund	Major Street Fund	\$ 2,831
	Nonmajor governmental funds	2,831
	Water and Sewer Fund	<u>20,058</u>
	Total General Fund	<u>\$ 25,720</u>

This balance results from the time lag between the dates that goods and services are provided or reimbursable expenditures occur, transactions are recorded in the accounting system, and payments between funds are made. The Equipment Fund owes the General Fund, Water and Sewer Fund, and Downtown Development Authority for loans to purchase a fire truck.

Receivable Fund	Payable Fund	Amount
Advances from/to Other Funds		
Water and Sewer Fund	Equipment Fund	\$ 25,000
Downtown Development Authority	Equipment Fund	<u>38,916</u>
	Total	<u>\$ 63,916</u>

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 6 - Interfund Receivables, Payables, and Transfers (Continued)

The advances represent money loaned to the Equipment Fund for the purchase of a new fire truck. Annual principal and interest payments will be made each year, ending in 2015.

Interfund transfers reported in the fund financial statements are comprised of the following:

<u>Fund Providing Resources</u>	<u>Fund Receiving Resources</u>	<u>Amount</u>
General Fund	Nonmajor governmental funds - 1999 Budget Bonds Fund	\$ 45,450
Major Street Fund	Local Street Fund	11,000
Cemetery Care Fund	General Fund	<u>200</u>
	Total	<u>\$ 56,650</u>

The transfer from the General Fund to the Debt Service Fund represents the use of unrestricted resources to finance the debt of the City. The transfer from the Major Street Fund to the Local Street Fund represents the sharing of gas and weight tax revenues, in accordance with Act 51.

Note 7 - Long-term Debt

The City issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the City. County contractual agreements and installment purchase agreements are also general obligations of the government. Special assessment bonds provide for capital improvements that benefit specific properties, and will be repaid from amounts levied against those properties benefited from the construction. In the event that a deficiency exists because of unpaid or delinquent special assessments at the time a debt service payment is due, the City is obligated to provide resources to cover the deficiency until other resources (such as tax sale proceeds or a re-assessment of the district) are received. Revenue bonds involve a pledge of specific income derived from the acquired or constructed assets to pay debt service.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 7 - Long-term Debt (Continued)

Long-term obligation activity can be summarized as follows:

	Interest Rate Ranges	Beginning Balance	Additions (Reductions)	Ending Balance	Due Within One Year
Governmental Activities					
Other governmental obligations:					
General obligation bonds					
1999 budget bonds:					
Amount of issue - \$550,000	4.50% -				
Maturing through 2020	5.75%	\$ 470,000	\$ (20,000) **	450,000	\$ 20,000
Special assessment limited tax bond:					
Special assessment district improvements:					
Amount of issue - \$850,000	3.15% -				
Maturing through 2024	5.15%	850,000	(45,000)	805,000	45,000
Employee compensated absences		50,640	2,144	52,784	52,784
Estimated personal property tax multiplier liability		31,231	(31,231)	-	-
Subtotal - Other governmental obligations		1,401,871	(94,087)	1,307,784	117,784
Internal Service Funds:					
Installment purchase obligations:					
Sewer vacor truck:					
Amount of issue - \$170,000					
Maturing through 2009	4.05%	67,350	(18,313)	49,037	19,057
Snow plow truck:					
Amount of issue - \$125,000					
Maturing through 2011	4.90%	85,000	(10,000)	75,000	15,000
Fire truck:					
Amount of issue - \$158,000	4.00% -				
Maturing through 2015	4.60%	-	158,000	158,000	12,000
Subtotal - Internal Service Funds		152,350	129,687	282,037	46,057
Total governmental activities		1,554,221	35,600	1,589,821	163,841
Business-type Activities					
Revenue bonds:					
Water System Extension:					
Amount of issue - \$580,000					
Maturing through 2019	6.25%	470,000	(20,000)	450,000	20,000
Water System Bonds:					
Amount of issue - \$180,000	4.90% -				
Maturing through 2020	6.00%	155,000	(5,000)	150,000	5,000
Junior Lien Revenue Bonds:					
Amount of issue - \$417,844					
Maturing through 2020	2.50%	332,844	(20,000)	312,844	20,000
County contractual obligation -					
Genesee County Water Supply System:					
Amount of issue - \$35,000					
Maturing through 2008	4.00%	21,000	(7,000)	14,000	7,000
Installment purchase obligations:					
Rosewood Water Line:					
Amount of issue - \$250,000					
Maturing through 2013	4.875%	215,000	(20,000)	195,000	25,000
Mt. Morris Road Water Line:					
Amount of issue - \$38,000					
Maturing through 2009	3.50%	30,400	(7,600)	22,800	7,600
Total business-type activities		1,224,244	(79,600)	1,144,644	84,600
Total business-type and governmental activities		\$ 2,778,465	\$ (44,000)	\$ 2,734,465	\$ 248,441

** This special assessment relates to a single taxpayer. The City will monitor the taxpayer's long-term ability to make special assessment payments.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 7 - Long-term Debt (Continued)

	Interest Rate Ranges	Beginning Balance	Additions (Reductions)	Ending Balance	Due Within One Year
Component Unit					
Downtown Development Authority					
Parking Lot Bonds					
Amount of issue - \$85,000					
Maturing through 2007	6.29%	\$ 16,000	\$ (8,000)	\$ 8,000	\$ 8,000
Parking lot land contract					
Amount of issue - \$40,000					
Maturing through 2006		7,500	(7,500)	-	-
Total component unit		<u>\$ 23,500</u>	<u>\$ (15,500)</u>	<u>\$ 8,000</u>	<u>\$ 8,000</u>

Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

	Governmental Activities			Business-type Activities			Component Unit		
	Principal	Interest	Total	Principal	Interest	Total	Principal	Interest	Total
2007	\$ 111,057	\$ 69,199	\$ 180,256	\$ 84,600	\$ 53,833	\$ 138,433	\$ 8,000	\$ 502	\$ 8,502
2008	112,841	62,564	175,405	89,600	50,021	139,621	-	-	-
2009	109,139	57,703	166,842	87,600	46,051	133,651	-	-	-
2010	99,000	53,379	152,379	85,000	42,042	127,042	-	-	-
2011	100,000	49,255	149,255	90,000	38,010	128,010	-	-	-
2012-2016	485,000	184,137	669,137	405,000	148,144	553,144	-	-	-
2017-2021	420,000	71,063	491,063	302,844	49,447	352,291	-	-	-
2022-2026	100,000	9,506	109,506	-	-	-	-	-	-
Total	<u>\$ 1,537,037</u>	<u>\$ 556,806</u>	<u>\$ 2,093,843</u>	<u>\$ 1,144,644</u>	<u>\$ 427,548</u>	<u>\$ 1,572,192</u>	<u>\$ 8,000</u>	<u>\$ 502</u>	<u>\$ 8,502</u>

Note 8 - Restricted Assets

Restricted assets of the Enterprise Fund include \$87,653 restricted for debt payments on the water supply and sewage disposal system revenue bonds at June 30, 2006. Restricted assets result from an allocation of the original bond proceeds and, accordingly, it is not necessary to reserve retained earnings for the amount of restricted assets.

Note 9 - Reserved Fund Balance

Fund balance has been reserved within the governmental funds for the following:

	Drug Forfeiture	PEG Grants	Land Held for Resale	Total Reserved Fund Balance
General Fund	<u>\$ 5,769</u>	<u>\$ 3,787</u>	<u>\$ 355,663</u>	<u>\$ 365,219</u>

Note 10 - Risk Management

The City is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The City has purchased commercial insurance for medical benefits provided to employees and participates in the Michigan Municipal League (MML) risk pool for claims relating to property loss, torts, errors and omissions, and employee injuries. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

The Michigan Municipal League risk pool program operates as a common risk-sharing management program for local units of government in Michigan; member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts.

Note 11 - Defined Benefit Pension Plan

Plan Description - The City participates in the Genesee County Employees' Retirement System (the "System"), an agent multiple-employer defined benefit pension plan that covers all employees of the City. The System provides retirement, disability, and death benefits to plan members and their beneficiaries. The Genesee County Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the System. That report may be obtained by contacting the System at 1101 Beach St., Flint, MI 48502.

Funding Policy - The City is required to contribute at an actuarially determined rate; the current rate is 18.47 percent of annual covered payroll. City employees are required to contribute 5 percent of their annual covered payroll. The contribution requirements of the City are established and may be amended by the Retirement Board of Genesee County Employees' Retirement System. The contribution requirements of plan members are established and may be amended by the City, depending on the Genesee County Employees' Retirement System contribution program adopted by the City.

City of Mt. Morris, Michigan

Notes to Financial Statements June 30, 2006

Note 11 - Defined Benefit Pension Plan (Continued)

Annual Pension Cost - For the year ended June 30, 2006, the City's annual pension cost of \$147,338 for the plan was equal to the City's required and actual contribution. The annual required contribution was determined as part of the actuarial valuations at December 31, 2004. The actuarial valuations use the entry age actuarial cost method. Significant actuarial assumptions used include (a) an 8 percent investment rate of return, (b) projected salary increases of 5.00 percent to 9.03 percent per year depending on age, attributable to seniority/merit, and (c) the assumption that benefits will increase 2.5 percent per year annually after retirement. Both (a) and (b) include an inflation component of 5.00 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is amortized over a period of 20 years.

	Fiscal Year Ended June 30		
	2006	2005	2004
Annual pension cost (APC)	\$ 147,338	\$ 102,813	\$ 70,864
Percentage of APC contributed	100%	100%	100%
Net pension obligation	-	-	-
	Actuarial Valuation as of December 31		
	2005	2004	2003
Actuarial value of asset	\$ 3,441,373	\$ 3,237,299	\$ 3,243,105
Actuarial accrued liability (AAL) (entry age)	\$ 4,389,058	\$ 4,230,351	\$ 3,744,874
Overfunded (unfunded) AAL (UAAL)	\$ (947,685)	\$ (993,052)	\$ (501,769)
Funded ratio	78%	77%	87%
Covered payroll	\$ 879,914	\$ 851,850	\$ 838,736
UAAL as a percentage of covered payroll	108%	117%	60%

Note 12 - Other Postemployment Benefits

The City provides life and health care benefits to all full-time employees upon retirement, in accordance with labor contracts. Currently, nine retirees are eligible. The City includes pre-Medicare retirees and their dependents in its insured health care plan. The City purchases Medicare supplemental insurance for retirees eligible for Medicare. Expenditures for postemployment health care benefits are recognized as the insurance premiums become due; during the year, this amounted to \$94,092. These benefits are paid annually from the Internal Service Fund.

Upcoming Reporting Change - The Governmental Accounting Standards Board has recently released Statement No. 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any “other” postemployment benefits (other than pensions). The new rules will cause the government-wide financial statements to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. The new pronouncement is effective for the year ending June 30, 2010.

Required Supplemental Information

City of Mt. Morris, Michigan

Required Supplemental Information Budgetary Comparison Schedule - General Fund Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Variance with Amended Budget Favorable (Unfavorable)
Resources (Inflows)				
Property taxes	\$ 755,000	\$ 740,137	\$ 744,891	\$ 4,754
Licenses and permits	27,700	20,200	20,258	58
Federal sources	38,000	36,888	23,889	(12,999)
State sources	415,500	407,088	407,093	5
Charges for services	222,960	225,360	225,207	(153)
Fines and forfeitures	57,000	58,835	56,822	(2,013)
Interest and rent	75,800	98,835	92,245	(6,590)
Operating transfers in	75,200	77,000	75,200	(1,800)
Total resources (inflows)	1,667,160	1,664,343	1,645,605	(18,738)
Expenditures				
Legislative	17,573	14,100	13,708	392
General government:				
Elections	36,914	33,810	33,804	6
Assessor	12,550	11,951	11,866	85
Attorney	55,000	70,100	70,971	(871)
Administration	133,997	137,528	133,768	3,760
City Treasurer	85,440	72,464	72,426	38
Accountant	21,000	24,215	24,215	-
City hall and grounds	113,000	115,964	106,598	9,366
Other city property	33,790	44,250	40,872	3,378
Cemetery	20,040	21,590	21,577	13
Total general government	511,731	531,872	516,097	15,775
Public safety:				
Police	685,860	776,330	761,685	14,645
Fire	79,210	63,000	63,127	(127)
Code enforcement	21,050	30,606	30,701	(95)
Planning commission	5,000	8,959	8,812	147
Total public safety	791,120	878,895	864,325	14,570

City of Mt. Morris, Michigan

Required Supplemental Information Budgetary Comparison Schedule - General Fund (Continued) Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Variance with Amended Budget Favorable (Unfavorable)
Expenditures (Continued)				
Public works:				
Public service	\$ 98,654	\$ 113,063	\$ 108,800	\$ 4,263
Sidewalks	58,271	37,320	33,468	3,852
Trash collection	115,364	122,426	120,351	2,075
Weed control	3,900	6,972	7,279	(307)
Total public works	276,189	279,781	269,898	9,883
Recreation, cultural, and other - Library	23,952	27,432	48,383	(20,951)
Contingency	-	-	46,092	(46,092)
Operating transfers out	45,450	45,450	45,450	-
Total expenditures	1,666,015	1,777,530	1,803,953	19,669
Net Change in Fund Balance	1,145	(113,187)	(158,348)	(45,161)
Fund Balance - Beginning of year	515,333	515,333	515,333	-
Fund Balance - End of year	\$ 516,478	\$ 402,146	\$ 356,985	\$ (45,161)

City of Mt. Morris, Michigan

Required Supplemental Information Budgetary Comparison Schedule Major Special Revenue Fund Year Ended June 30, 2006

	Major Streets Fund			
	Original Budget	Amended Budget	Actual	Variance with Amended Budget Favorable (Unfavorable)
Revenue				
State sources	\$ 154,029	\$ 150,772	\$ 149,975	\$ (797)
Interest	2,000	8,728	9,791	1,063
Rents, royalties, and other	4,000	1,293	12,797	11,504
Total revenue	160,029	160,793	172,563	11,770
Expenditures				
Public works	146,758	142,763	113,843	28,920
Operating transfer out	26,000	26,000	26,000	-
Total expenditures	172,758	168,763	139,843	28,920
Net Change in Fund Balance	(12,729)	(7,970)	32,720	40,690
Fund Balance - Beginning of year	262,126	262,126	262,126	-
Fund Balance - End of year	<u>\$ 249,397</u>	<u>\$ 254,156</u>	<u>\$ 294,846</u>	<u>\$ 40,690</u>

City of Mt. Morris, Michigan

Notes to Required Supplemental Information June 30, 2006

Note 1 - Reconciliation of Budgeted Amounts to Basic Financial Statements

The budgetary comparison schedules for the General and Major Special Revenue Funds are presented on the same basis of accounting used in preparing the adopted budget. Following is a reconciliation of the budgetary comparison schedule to the governmental funds (statement of revenue, expenditures, and changes in fund balances):

	General Fund		Major Streets Fund	
	Total Revenue	Total Expenditures	Total Revenue	Total Expenditures
Amounts per operating statement	\$ 1,630,405	\$ 1,743,503	\$ 172,563	\$ 128,843
Operating transfers budgeted as revenue and expenditures	200	45,450	-	11,000
Reimbursements shown net of expenditures budgeted as operating transfers	15,000	15,000	-	-
Amounts per budget statement	<u>\$ 1,645,605</u>	<u>\$ 1,803,953</u>	<u>\$ 172,563</u>	<u>\$ 139,843</u>

Note 2 - Budgetary Information

Budgetary Information - Annual budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America for the General Fund and all Special Revenue Funds except that operating transfers and debt proceeds have been included in the "revenue" and "expenditures" categories, rather than as "other financing sources (uses)." All annual appropriations lapse at fiscal year end. During the year, the budget was amended in a legally permissible manner.

City of Mt. Morris, Michigan

Notes to Required Supplemental Information June 30, 2006

Note 2 - Budgetary Information (Continued)

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. On or before the first Monday in May, the treasurer and the City manager prepare a proposed operating budget for the fiscal year commencing July 1 and submit it to the City Council. The budget must be adopted through a passage of a budget resolution no later than the second Monday in June. During the year, the budget was not passed until after the required date.
2. Public hearings are conducted to obtain citizen comments.
3. The legislative budget is adopted by department and fund on an activity basis. Line item detail is provided as a general guideline. Throughout the year, the Council receives requests to amend the activity budget. All amendments over \$5,000 must be approved by a vote of the City Council. Amendments to the budget under \$5,000 and changes in line items within an activity may be approved by the City manager.

Excess of Expenditures Over Appropriations in Budgeted Funds - During the year, the City incurred expenditures that were in excess of the amounts budgeted as follows:

	Budget	Actual
General Fund - Recreation, culture, and other - Library	\$ 27,432	\$ 48,383
General Fund - Contingency	-	46,092

The unfavorable variance in the recreation, culture, and other line was caused by the recording of a liability in the General Fund related to the personal property tax multiplier case with the utility companies in the current year that was not budgeted for by the City. The unfavorable variance in the contingency line was caused by the City's decision to adjust immaterial old and unknown account balances.

Other Supplemental Information

City of Mt. Morris, Michigan

Other Supplemental Information Combining Balance Sheet Nonmajor Governmental Funds June 30, 2006

	Special Revenue Funds	Debt Service Fund	Capital Project Fund	Permanent Fund	
	Local Streets	1999 Budget Bonds	Special Assessment Fund	Cemetery Care	Total Nonmajor Governmental Funds
Assets					
Cash and cash equivalents	\$ 49,814	\$ 1,457	\$ 21,320	\$ 63,457	\$ 136,048
Due from other governmental units	8,328	-	-	-	8,328
Total assets	<u>\$ 58,142</u>	<u>\$ 1,457</u>	<u>\$ 21,320</u>	<u>\$ 63,457</u>	<u>\$ 144,376</u>
Liabilities and Fund Balances					
Liabilities					
Accrued and other liabilities	\$ 1,420	\$ -	\$ -	\$ -	\$ 1,420
Due to other funds	2,831	-	-	-	2,831
Total liabilities	4,251	-	-	-	4,251
Fund Balances - Unreserved	<u>53,891</u>	<u>1,457</u>	<u>21,320</u>	<u>63,457</u>	<u>140,125</u>
Total liabilities and fund balances	<u>\$ 58,142</u>	<u>\$ 1,457</u>	<u>\$ 21,320</u>	<u>\$ 63,457</u>	<u>\$ 144,376</u>

City of Mt. Morris, Michigan

Other Supplemental Information Combining Statement of Revenue, Expenditures, and Changes in Fund Balances - Nonmajor Governmental Funds Year Ended June 30, 2006

	Special Revenue Funds	Debt Service Fund	Capital Project Fund	Permanent Fund	
	Local Streets	1999 Budget Bonds	Special Assessment Fund	Cemetery Care	Total Nonmajor Governmental Funds
Revenue					
State sources	\$ 50,441	\$ -	\$ -	\$ -	\$ 50,441
Interest	1,792	222	-	2,178	4,192
Other	8,027	-	-	860	8,887
Total revenue	60,260	222	-	3,038	63,520
Expenditures					
Public works	75,630	-	-	-	75,630
Debt service	-	45,670	-	-	45,670
Other	-	-	102	-	102
Total expenditures	75,630	45,670	102	-	121,402
Excess of Revenue Over (Under) Expenditures	(15,370)	(45,448)	(102)	3,038	(57,882)
Other Financing Sources (Uses)					
Operating transfers in	11,000	45,450	-	-	56,450
Operating transfers out	-	-	-	(200)	(200)
Total other financing sources (uses)	11,000	45,450	-	(200)	56,250
Net Change in Fund Balances	(4,370)	2	(102)	2,838	(1,632)
Fund Balances - Beginning of year	58,261	1,455	21,422	60,619	141,757
Fund Balances - End of year	<u>\$ 53,891</u>	<u>\$ 1,457</u>	<u>\$ 21,320</u>	<u>\$ 63,457</u>	<u>\$ 140,125</u>

City of Mt. Morris, Michigan

Other Supplemental Information Combining Statement of Net Assets Internal Service Funds June 30, 2006

	Equipment	Retiree Benefits	Total
Assets			
Current assets - Cash and investments	\$ 82,133	\$ 2,161	\$ 84,294
Noncurrent assets - Depreciable capital assets	<u>452,703</u>	<u>-</u>	<u>452,703</u>
Total assets	534,836	2,161	536,997
Liabilities			
Current liabilities:			
Accounts payable	4,794	-	4,794
Accrued and other liabilities	4,140	-	4,140
Current portion of long-term debt	<u>46,057</u>	<u>-</u>	<u>46,057</u>
Total current liabilities	54,991	-	54,991
Noncurrent liabilities:			
Advances from other funds	25,000	-	25,000
Advance from component unit	38,916	-	38,916
Long-term debt - Net of current portion	<u>235,980</u>	<u>-</u>	<u>235,980</u>
Total noncurrent liabilities	<u>299,896</u>	<u>-</u>	<u>299,896</u>
Total liabilities	<u>354,887</u>	<u>-</u>	<u>354,887</u>
Net Assets			
Investment in capital assets - Net of related debt	106,750	-	106,750
Unrestricted	<u>73,199</u>	<u>2,161</u>	<u>75,360</u>
Total net assets	<u><u>\$ 179,949</u></u>	<u><u>\$ 2,161</u></u>	<u><u>\$ 182,110</u></u>

City of Mt. Morris, Michigan

Other Supplemental Information Combining Statement of Revenue, Expenses, and Changes in Net Assets Internal Service Funds Year Ended June 30, 2006

	Equipment	Retiree Benefits	Total
Operating Revenue			
Charges for services	\$ 245,403	\$ 71,000	\$ 316,403
Other income	<u>10</u>	<u>-</u>	<u>10</u>
Total operating revenue	245,413	71,000	316,413
Operating Expenses			
Wages and salaries	20,615	-	20,615
Fringe benefits	10,540	-	10,540
Supplies	31,395	-	31,395
Operating	69,148	-	69,148
Insurance	25,696	-	25,696
Retiree benefits	-	94,092	94,092
Depreciation	<u>52,501</u>	<u>-</u>	<u>52,501</u>
Total operating expenses	<u>209,895</u>	<u>94,092</u>	<u>303,987</u>
Operating Income (Loss)	35,518	(23,092)	12,426
Nonoperating Revenue (Expense)			
Federal sources	10,000	-	10,000
Interest income	1,961	341	2,302
Interest expense	<u>(8,747)</u>	<u>-</u>	<u>(8,747)</u>
Total nonoperating revenue	<u>3,214</u>	<u>341</u>	<u>3,555</u>
Change in Net Assets	38,732	(22,751)	15,981
Net Assets - Beginning of year	<u>141,217</u>	<u>24,912</u>	<u>166,129</u>
Net Assets - End of year	<u><u>\$ 179,949</u></u>	<u><u>\$ 2,161</u></u>	<u><u>\$ 182,110</u></u>

City of Mt. Morris, Michigan

Other Supplemental Information Combining Statement of Cash Flows Internal Service Funds Year Ended June 30, 2006

	Equipment	Retiree Benefits	Total
Cash Flows from Operating Activities			
Receipts from other funds	\$ 245,413	\$ 71,000	\$ 316,413
Payments to suppliers	(124,516)	(94,092)	(218,608)
Payments to employees	(31,155)	-	(31,155)
Other receipts	2,384	-	2,384
Net cash provided by (used in) operating activities	92,126	(23,092)	69,034
Cash Flows from Capital and Related Financing Activities			
Purchase of capital assets	(283,747)	-	(283,747)
Proceeds from issuance of debt	158,000	-	158,000
Funds received from federal sources	10,000	-	10,000
Advances from other funds/governmental units	63,916	-	63,916
Principal and interest paid on long-term debt	(37,059)	-	(37,059)
Net cash used in financing activities	(88,890)	-	(88,890)
Cash Flows from Investing Activities - Interest received on investments	1,961	341	2,302
Net Increase (Decrease) in Cash and Cash Equivalents	5,197	(22,751)	(17,554)
Cash and Cash Equivalents - July 1, 2005	76,936	24,912	101,848
Cash and Cash Equivalents - June 30, 2006	<u>\$ 82,133</u>	<u>\$ 2,161</u>	<u>\$ 84,294</u>
Reconciliation of Operating Income (Loss) to Net Cash from Operating Activities			
Operating income (loss)	\$ 35,518	\$ (23,092)	\$ 12,426
Adjustments to reconcile operating income (loss) to net cash from operating activities:			
Depreciation and amortization	52,501	-	52,501
Changes in assets and liabilities:			
Due from other funds	18	-	18
Accounts payable	1,723	-	1,723
Accrued and other liabilities	2,366	-	2,366
Net cash provided by (used in) operating activities	<u>\$ 92,126</u>	<u>\$ (23,092)</u>	<u>\$ 69,034</u>



Plante & Moran, PLLC
Suite 400
1000 Oakbrook Drive
Ann Arbor, MI 48104
Tel: 734.665.9494
Fax: 734.665.0664
plantemoran.com

August 30, 2006

To the Honorable Mayor and Members
of the City Council
City of Mount Morris, Michigan
11649 North Saginaw Street
Mount Morris, MI 48458-2092

Dear Mayor and Council Members:

We have recently completed the audit of the basic financial statements of the City of Mount Morris (the "City") for the year ended June 30, 2006. In addition to our audit report, we offer the following comments and recommendations for your consideration:

Financial Results

During the year ended June 30, 2006, the City's General Fund unreserved fund balance has been completely eliminated, leaving a \$(8,234) fund deficit. Overall, revenues increased approximately 2 percent from the prior year but expenditures increased approximately 8 percent from the prior year. This caused a decrease in General Fund fund balance of \$148,348. While the City's revenues maintained relatively consistent, the rise in police department expenditures, mainly fringe benefits, and for tax tribunal cases caused a large jump in expenditures. The City is facing very challenging financial times. The City should consider developing multi-year operational and capital plans.

State-shared Revenue

Municipalities in Michigan have and will continue to feel the effects of the slowdown in the state's economy. State-shared revenue totaled \$403,253 in 2006 and accounted for 25 percent of the City's total General Fund revenue. Because of slower than anticipated growth in the State's sales tax collections (the sole source of revenue-sharing payments to local units of government) and the State's budget problems, which have resulted in additional appropriation reductions to the revenue-sharing line item in the State's budget, revenue-sharing payments for the last several years have been lower than anticipated.

Although sales tax revenue would support an increase to state-shared revenue payments, the State's budget situation remains troublesome at best. It is generally acknowledged that the State's budget woes will continue for several more years. As a result, we continue to urge the City to be conservative in its estimation of state-shared revenue as this line item in the State's budget remains vulnerable.



A worldwide association of independent accounting firms

The table below details state-shared revenue for the City over the past five years. In addition, the table details the cumulative revenue lost by the City as a result of not receiving state-shared revenue payments consistent with annual increases in inflation since 2001.

City Fiscal Year Ended June 30		Actual Revenue Sharing		Revenue Sharing if City Received Inflationary Increases		Cumulative Lost Revenue-sharing Payments
2001		\$ 467,728		\$ 467,728		\$ -
2002		449,129		482,695		33,566
2003		432,755		489,935		90,746
2004		429,688		501,203		162,261
2005		409,015		512,731		265,977
2006		403,253		529,651		392,375

If the State were to eliminate the statutory portion of revenue sharing (as the constitutional portion cannot be modified without a change to the State's constitution), the City has approximately \$178,000 at risk in its General Fund budget based on the State's budget for the 2006-2007 year. We will continue to update the City as developments occur. The statutory formula expires in 2007 and requires action by the legislature.

We will continue to update the City as developments occur.

Property Taxes

Proposal A

As you recall, Proposal A limits the growth in taxable value to the lesser of inflation or 5 percent. The inflation factor for this calculation is published by the State Tax Commission and is as follows:

2006	3.3%	2001	3.2%
2005	2.3%	2000	1.9%
2004	2.3%	1999	1.6%
2003	1.5%	1998	2.7%
2002	3.2%	1997	2.8%

As indicated above, growth in existing property is significantly limited due to Proposal A to an average of 2.48 percent annually over the past 10 years. This factor should be considered when the City is involved in long-term financial planning.

The Headlee Amendment to the Michigan Constitution limits the amount of taxes that can be levied by the City. In general terms, if growth in the City's existing property tax base exceeds inflation for a particular year, the Headlee Amendment requires the City to "roll back" its property tax rate to inflation. Prior to the passage of Proposal A in 1994, during years when the growth on the City's existing property tax base was less than inflation, the Headlee Amendment allowed the City to "roll up" its property tax rate and recover from years when the property tax rate was "rolled back." However, subsequent to the passage of Proposal A, the City is no longer allowed to "roll up" its property tax rate in years when growth on its existing tax base is less than inflation. As a result, despite general operating charter mills of 20, currently the Headlee limited mills are 18.1411 (a reduction of 8 percent).

Property Tax Remittances

During the normal course of the year, the deputy treasurer would input the tax receipts into Genesee County's dial-up tax system "G-Link." Once inputted into the county system, the deputy would then report this information to the treasurer, who would actually disperse the tax monies to the other local units of government. However, during the winter of 2006, the deputy treasurer unexpectedly needed to take a leave of absence. Due to this shortage of personnel, a tax disbursement was not remitted to the other governmental units in a timely manner. The payments were remitted as of June 30, 2006 and the situation has since been corrected.

Retiree Health Care Funding

The Governmental Accounting Standards Board (GASB) has recently released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The intent of the new rules is to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. These new rules will apply to the government-wide financial statements, rather than the individual fund level.

However, the new pronouncement will require a valuation of the obligation to provide retiree health care benefits, including an amortization of the past service cost over a period of up to 30 years. The valuation must include an annual recommended contribution (ARC). While the ARC does not need to be funded each year, any underfunding must be reported as a liability on the government-wide statement of net assets. We anticipate that this will result in significant pressure to fund the actuarially recommended contribution on an annual basis.

This statement will be effective for the City's 2010 fiscal year. The requirement for a valuation allows for an internal valuation to be performed (without the need to hire an actuary) only if you have less than 100 total participants (defined as the sum of retirees currently receiving benefits, plus terminated employees who are eligible to receive in the future, plus current employees for which you have offered retiree health care). It appears the City meets these criteria.

Water and Sewer Fund

The bond ordinance for the water and sewer revenue bonds stipulates that the City periodically transfer net revenue to a fund segregated for debt service payments so that the balance in the fund is equal to the lesser of the maximum annual debt service requirements on the bonds for any future year, 125 percent of average annual debt requirement on the bonds, or 10 percent of the proceeds plus the lesser of 5 percent of the proceeds or \$100,000. This fund must also include an additional amount which represents a portion of the next principal and interest payments due. The City has sufficient reserves established and should annually perform the covenant calculation to ensure continued compliance with the covenants or make excess funds available for debt service as a result of decreases in required reserves.

During 2003, the City had a study done regarding the rate structure of the Water and Sewer Fund. We commend the City on taking steps to improve its rate structure to become more compliant with state regulations. However, we would encourage the City to continue with its review of the rate structure annually to ensure continued compliance for all users of the system.

Solid Waste Collection and Disposal

During April 2004, the City approved a new contract for residential solid waste collection and disposal services. On a go-forward basis, the City may want to consider calculating the cost of the service, including overhead, and compare it to the revenues generated by resident fees. Depending on the results of this calculation, the City may need to re-evaluate the fee being charged to its residents. We recommend that the City continue to perform this calculation and monitor the results.

Account Reconciliations

Currently, the water and sewer receivable, garbage and recycling receivable, and unallocated fringe benefits account are not reconciled from the general ledger to detailed reports on a periodic basis. This resulted in the City proposing journal entries of approximately \$46,000 to adjust the general ledger to agree to the client's detail of these accounts. The City should consider incorporating these reconciliations in its monthly procedures as these reconciliations help to ensure the accuracy of the general ledger throughout the year.

Municipal Finance Act Revisions - Reminder

The Municipal Finance Act was amended several years ago. Communities are now required to submit a filing once a year with the Michigan Department of Treasury. The old 10-day "exemption from prior approval" process has been eliminated and is replaced with this qualification process. This filing will serve as a pre-approval for future debt issues. The current filing is due within six months of the City's year end June 30, 2006, and is good for one year thereafter.

To the Honorable Mayor and Members
of the City Council
City of Mount Morris, Michigan

5

August 30, 2006

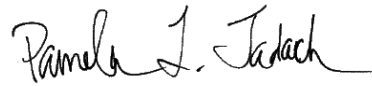
We would like to thank the council for the opportunity to serve as auditors for the City. We would also like to express our appreciation for the courtesy and cooperation extended to us by the administration during the audit. If you would like to discuss any of these matters, or would like assistance in their implementation, please contact us.

Very truly yours,

Plante & Moran, PLLC

A handwritten signature in cursive script, appearing to read "David H. Helisek".

David H. Helisek

A handwritten signature in cursive script, appearing to read "Pamela L. Jadach".

Pamela L. Jadach